In the Supreme Court of the United States

OCTOBER TERM, 1973

SUSQUEHANNA COAL COMPANY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

MEMORANDUM FOR THE RESPONDENT IN OPPOSITION

The sole issue the petitioner raises is whether, in a series of transactions in 1958, it acquired a depletable economic interest in certain coal deposits during the years 1962-1964. Both courts below concluded that petitioner did not acquire such an interest.

1. In 1958 L. Biscontini & Sons ("Biscontini") was a partnership engaged in mining coal. It desired to purchase the coalbearing Newport Lands from Glen Alden Corporation, the owner (Pet. App. 35). M. A. Hanna Company ("Hanna"), a coal processor and seller, agreed to serve as intermediary and negotiated the sale for a total sum of $1,600,000, payable $375,000 down and $40,000 a year for the balance, plus tonnage payments for coal mined in excess of 200,000 tons in any one year. Although Hanna was the formal purchaser and took title to the property, pursuant to agreements with Hanna Biscontini paid the down payment, assumed liabil-

ity for the subsequent mortgage payments and real estate taxes, and was entitled to a deed to the property at a specified later date. Biscontini borrowed $100,000 of the $375,000 down payment from Hanna—which was thereafter repaid (Pet. App. 62, n. 1).

Under an Operating Agreement between Hanna and Biscontini, (Pet. App. 17-31), Hanna was given the exclusive right to market the coal mined by Biscontini from the Newport Lands and undertook to pay Biscontini specified prices for the coal. Until Hanna actually conveyed the property to Biscontini, Hanna had the right to terminate its agreements with Biscontini for cause (such as Biscontini's financial difficulties) and to acquire possession of the property (Pet. App. 37-39, 62-63).

Thereafter, petitioner became Hanna's successor in interest and Glen Nan became Biscontini's successor in interest. Petitioner's right to terminate the agreements was never exercised. Biscontini and its successor, Glen Nan, duly paid the entire purchase price of the property and it was deeded to Glen Nan immediately after the taxable years involved (Pet. App. 39, 62).

On their tax returns for the taxable years at issue, Glen Nan and petitioner both claimed depletion deductions with respect to the Newport Lands. The Commissioner, in the position of a stakeholder, denied both claims (Pet. App. 44-45). Upon analysis of the substance of the various agreements between the parties, the Tax Court determined that Biscontini was the beneficial owner of the property from the time it was purchased in Hanna's name; that Biscontini's payment of the purchase price was a capital investment in the coal in

place; that Biscontini looked solely to income derived from extraction for a return of the investment; and, consequently, that Biscontini had a depletable economic interest in the property. Conversely, the court concluded that Hanna (and its successor, petitioner) had only a non-depletable economic advantage stemming from its exclusive sales arrangement with Biscontini (and its successor, Glen Nan) (Pet. App. 44-53). The court of appeals affirmed *per curiam* (Pet. App. 60-65).

2. As this Court stated in *Commissioner* v. *Southwest Expl. Co.*, 350 U.S. 308, 312, the depletion allowance authorized by Sections 611 and 613 of the Internal Revenue Code of 1954 "is based on the theory that the extraction of minerals gradually exhausts the capital investment in the mineral deposit," and "is designed to permit a recoupment of the owner's capital investment in the minerals so that when the minerals are exhausted, the owner's capital is unimpaired." In accord with that objective, the Court has determined that a taxpayer must have an economic interest in minerals in place in order to claim the depletion allowance. In *Palmer* v. *Bender*, 287 U.S. 551, 557, the Court defined a depletable economic interest in terms of two requirements, which are set forth in Treasury Regulations, Section 1.611-1(b)(1), as follows:

> An economic interest is possessed in every case in which the taxpayer has acquired by investment any interest in mineral in place * * * and secures, by any form of legal relationship, income derived from the extraction of the mineral * * *, to which he must look for a return of his capital.

Thus, a taxpayer is entitled to depletion if, and only if, he has made a capital investment in the minerals in place and looks solely to income derived from extrac-

tion for a return of his capital. Neither the locus of legal title nor the nomenclature employed in a transfer of mineral rights is determinative. *Palmer* v. *Bender, supra; Burton-Sutton Oil Co.* v. *Commissioner,* 328 U.S. 25, 32.[1]

By contrast, a taxpayer has a non-depletable economic advantage where he does not make a capital investment in minerals in place but profits from mineral production solely by reason of his contractual relations with the owner of the deposit. *Helvering* v. *Bankline Oil Co.,* 303 U.S. 362; *Parsons* v. *Smith,* 359 U.S. 215; *Paragon Coal Co.* v. *Commissioner,* 380 U.S. 624. Whether a taxpayer has acquired an economic interest in minerals in place, or only an economic advantage, depends upon the relationship of the parties. *Paragon Coal Co.* v. *Commissioner, supra,* 380 U.S. at 627.

Here, both courts below correctly concluded that petitioner did not have an economic interest in the coal in place. The undisputed facts demonstrate that petitioner and its predecessor, Hanna, did not make a capital investment in the coal in place, recoverable from income derived from extraction within the meaning of this Court's "economic interest" decisions. Biscontini acquired the entire beneficial ownership of the Newport Lands by making the down payment of the purchase price

---

[1]Petitioner contends (Pet. 10) that the court of appeals held that it acquired a leasehold interest under its agreements with Biscontini. This is not the case. The court simply assumed *arguendo* that the 1958 agreements might be subject to a sale and leaseback construction (Pet. App. 63). But in all events, a lessee, like every other taxpayer, must demonstrate that it has a depletable economic interest.

through Hanna, as intermediary, and assuming and discharging the obligation to pay the balance in the form of mortgage payments. As a result, Biscontini and its successor Glen Nan acquired the depletable economic interest in the coal in place.

Nothing that Hanna did entitled it to a share in this economic interest. Rather, to the extent that Hanna's services were an investment at all, they were an investment in and *quid pro quo* for the Operating Agreement between Biscontini and Hanna and the exclusive sales arrangement reflected in that agreement. Hanna looked to the exclusive sales arrangement for profits, not to income derived from extraction of the coal.

Significantly, petitioner's attempt to demonstrate that its predecessor Hanna had an economic interest in the coal speaks of its investment "in the Operating Agreement" and its services in acquiring the lands, the loan to Biscontini, and its provision of machinery (Pet. 11). But these are simply contractual obligations incident to its purchase and sales activities; they do not establish an economic interest in a mineral in place. An investment in depreciable mining equipment and machinery is not an investment in the minerals in place. To the contrary, such an outlay is recoverable only through depreciation deductions, and not by means of depletion. *Parsons* v. *Smith, supra; Paragon Coal Co.* v. *Commissioner, supra; Utah Salt Co.* v. *Wise,* 370 F. 2d 976 (C.A. 10); *CBN Corp.* v. *United States,* 364 F. 2d 393 (Ct. Cl.); *Scofield* v. *La Gloria Oil and Gas Co.,* 268 F. 2d 699 (C.A. 5).

Moreover, the fact that Hanna retained legal title until Biscontini had paid the purchase price for the Newport Lands, and had the right which was never exercised to terminate its agreements with Biscontini in the

event of non-performance, does not establish an economic interest in the coal in place. These were merely security devices which did not militate against Biscontini's beneficial ownership of the property. It is that beneficial ownership which gave Biscontini the depletable economic interest in the coal in place.

Hanna's interest in the transaction derived solely from the contractual arrangement whereby it would purchase all of the coal mined by Biscontini for a fixed price and thereafter sell it. While succession to this contractual right gave petitioner the economic advantage previously held by Hanna, both courts below correctly concluded that such a right did not establish a depletable economic interest in the coal in place.

For the reasons stated, it is respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

MAY 1974.